

Central Intelligence Agency



Washington, D. C. 20505

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4 December 1981

MEMORANDUM FOR: Allen J. Lenz  
Staff Director  
National Security Council

SUBJECT: Request for Examination of Longer Term  
Prospects for the Polish Economy [redacted]

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1. Attached, please find the paper you requested in your memorandum of 18 November. It was prepared by analysts in the Offices of European and Soviet Analysis, National Foreign Assessment Center, [redacted]

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to whom requests for clarification may be directed  
[redacted]

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2. It is my understanding that the principal drafters of this paper had direct conversations with you in an attempt to assure the paper's proper focus. It profited also from comments provided by the National Intelligence Officer for the USSR-EE and by the members and staff of the National Intelligence Council.

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[redacted]  
Executive Secretary

Attachment:

The Impact of Aid on Poland's  
Prospects [redacted] EUR-M 81-10024

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SUBJECT: Request for Examination of Longer Term  
Prospects for the Polish Economy

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CENTRAL INTELLIGENCE AGENCY  
National Foreign Assessment Center

4 December 1981

MEMORANDUM

The Impact of Aid on Poland's Prospects

Key Judgments

*Poland's desperate financial and economic situation continues to deteriorate. Additional Western aid could be an important, but not a sufficient, condition for Poland's being able either to continue limping along or to make an economic recovery. Other factors are currently of overriding importance, such as whether the regime and Solidarity can arrive at a power-sharing arrangement and whether Warsaw would use the aid rationally and implement sound policies. Both the regime and Solidarity have individually appealed for aid, in no small part to strengthen their opposing positions in negotiations with each other.*

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*Continuation of the present ad hoc aid system could permit the Poles to muddle through for some time by helping them meet their heavy financial obligations. Such aid would provide the regime and Solidarity more time to work toward a modus vivendi and to make a start on putting their economic house back in order. The risk would remain, however, that the Poles might at some point obtain too little aid to maintain their financial juggling act. A moratorium or*

*This memorandum was prepared by the East European Division, Office of European Analysis, with contributions from the Office of Soviet Analysis. It was requested by [ ] the National Security Council. Research was completed on 27 November 1981. Comments and questions are welcome and should be addressed to [ ] Chief, East European Division, EURA, [ ]*

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default might then follow that could have serious consequences for Poland and for some Western banks. The other risk is that the domestic political and economic situation could further unravel, leading to Soviet intervention. [REDACTED]

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A massive Western aid effort over several years could make a difference by enabling the Poles to avert default and by providing a net flow of resources to help revive the economy. To assure an adequate improvement in import capabilities, we estimate that Poland will need near-total relief from debt service payments totaling roughly \$10 billion annually and an additional \$1-2 billion a year in new loans. Such a program, moreover, would best include not only the 16 Western governments that have been negotiating with Warsaw as a group but also private banks and those official creditors not now participating in debt rescheduling. Only a broadly coordinated program of this sort could prevent an inequitable leakage of benefits from Poland to non-participating Western creditors. Even more difficult to guard against would be a matched withdrawal of Soviet assistance, which Moscow might well be tempted to try given its own worsening financial problems. Finally, to be effective and thus more acceptable to the Western creditors involved, the program might also require Western political and economic conditions that both the Polish regime and Moscow would find hard to accept. [REDACTED]

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Should the West, despite all the impediments, manage to mount an aid effort--and the Poles use that aid to best advantage--a substantial return might be realized on the investment. In humanitarian terms, Poland would have been assisted in the development of a pluralistic society more akin to those of the West than the East. The establishment of a new, liberal variant of socialism would, moreover, continue the long-term trend of increasing political and economic diversity among the USSR's allies in the Warsaw Pact and CEMA, in turn weakening the cohesion of these organizations and Soviet ability to use them as mechanisms of control. The Soviets, already concerned about Poland's reliability as a

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*military ally, might also conclude that a liberalized Poland constituted a shift in the central European balance of power of sufficient magnitude to require basic adjustments in their strategic planning.* [REDACTED]

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### The Current Situation

Poland is experiencing a precipitous economic decline. Production has dropped sharply this year in nearly every sector, and gross output for 1981 will be near the level of the early 1970s. The domestic market is close to collapse; rapid increases in money incomes, price inflexibility, and a decline in available goods have caused widespread hoarding, speculation, and bartering. Worker frustration over the regime's political tactics and shortages of food and consumer goods have led to increased strikes, decreased productivity, and a reluctance to work overtime. Farmers increasingly have refused to sell their output for a currency that will buy them little in return. [REDACTED]

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Growing trade and financial problems are exerting continuing downward pressures on the economy. Government cutbacks in imports necessitated by lack of foreign exchange have hurt industrial output. This, in turn, has further reduced exports. Warsaw has struggled all year to avert financial default, but is having a difficult time coming up with a \$500 million interest payment due to private creditors this month. It faces another unpayable debt financing bill next year. In light of continuing Soviet rebuffs of Polish government requests for aid, the regime and Solidarity are independently appealing even more strenuously for major assistance from the West--in part, to buttress their political bargaining power with each other. [REDACTED]

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Warsaw approached Western governments in the fall of 1980 to reschedule 1981-1983 debt service and to obtain several billion dollars in financial credits and commodity credit guarantees. Western governments were unwilling at that time to commit themselves to a long run aid package for Poland in the face of concerns about Soviet invasion and about the outcome of the clash between Solidarity and the government. Moreover, most Western countries faced tight budgets and considered prospects poor for Poland to repay any new credits. In the end, they opted to reschedule 90 percent of debt service due in the last eight months of 1981 and to consider future rescheduling at six-month intervals. Negotiations on future debt relief were to involve creditors in reviewing Polish economic performance to determine if balance-of-payments targets were met and if stabilization

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policies were successful. Western governments also have extended new commodity credits for food, semi-manufactured goods, and spare parts, but only on a piecemeal basis and after heavy pressure from the Poles and occasionally from other creditors.

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Western debt relief and credits have helped to provide most of what Poland needed to cover its 1981 financing requirement. Debt relief by the 16 Western governments involved in the joint rescheduling amounted to \$2.2 to 2.4 billion, and credits guaranteed by Western governments totalled about \$4 billion. Western banks provided assistance by allowing Poland an informal moratorium on \$2.3 billion in principal payments due since early this year. Finally, Western help has been augmented by an estimated \$1 billion in hard currency aid and credits from the USSR.

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While Warsaw has thus received about \$9 billion in hard currency debt relief and credits this year, this has not been enough to ease its supply problems. Due to continuing debt service obligations to banks and to those official creditors who did not join in rescheduling, Warsaw had to cut imports drastically--thus worsening production problems and further reducing export capability. To complete rescheduling of principal payments due private creditors in 1981, Warsaw must yet pay about \$500 million to become current on interest payments by the end of the year. The Poles' efforts to obtain the funds apparently have fallen short, and proposals to delay signature of the rescheduling may not work because the banks apparently must receive the interest by 31 December to meet legal requirements.

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A strong desire on the part of both the bankers and the Poles to avoid default may yet lead to a solution through some sort of deferral arrangement. Alternatively, the USSR or another source still could provide the Poles with a last-minute infusion of hard currency. In any case, time is running out, and Warsaw's failure to make the payment could trigger a formal default.

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#### What Poland Needs

If Warsaw does manage to escape formal default this month, the reprieve could well be short-lived. Next year Poland will have a staggering financing requirement of \$10 - \$11 billion. Debt relief extended on 1981 terms would cover \$5.5 billion, leaving Warsaw with a "financial gap" that, adjusting for

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services and other financial flows, would amount to \$3 to \$5 billion.<sup>1</sup> This could be covered by: 1) more comprehensive rescheduling than in 1981 of interest payments due private banks or of debt service to "non-16" creditors; 2) new credits or assistance from banks, Western governments, or the Soviets; or 3) a moratorium. [redacted]

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The crush of debt service obligations will not subside after 1982. While Warsaw had originally planned to reschedule only through 1983, rescheduling probably will be necessary for most of the 1980s. Interest payments will be high because of the growing size of the debt and because debt relief payments will be at spreads above market rates. Warsaw projects about \$4 billion annually in interest costs, but this estimate might well be too low. Debt amortization will amount to nearly \$6 billion annually through the mid-1980s and will begin to increase after 1985. By then, Warsaw will have to resume repaying total principal obligations unless additional rescheduling occurs. As a result of these obligations and those coming due on other loans that Warsaw will need in the next few years, principal payments could average more than \$10 billion annually in the 1987-1990 period and total debt service could average \$15 billion per year. [redacted]

In addition to credits or debt relief to stave off formal default, we estimate that Warsaw needs \$1-\$2 billion annually during at least 1982-1983 if imports are to rise enough to permit moderate economic recovery and to alleviate consumer shortages. In contrast with Warsaw's plans for a reduction in real imports in 1982 and zero growth through 1987, we estimate that sustainable economic recovery would require a rise in real imports by about 10 to 15 percent annually in 1982-1983 and thereafter by about 2 to 4 percent annually. Much of this import growth would have to come from the West because Warsaw is dependent on the West for more than four-fifths of its food and agricultural imports and more than half of its imports of non-fuel raw materials and chemicals. In specific terms, Polish industry now desperately needs Western raw and semifinished

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<sup>1</sup> The range in the estimate reflects our uncertainty whether Poland will have to pay \$2.2 billion in government-guaranteed principal payments that it owes creditors who are not part of the 16 countries which reached a multilateral rescheduling agreement. Not included in these 16 are communist countries, Brazil, Arab countries, and perhaps other Third World countries. Whether these "non-16" creditors are paid has a major impact on the size of Poland's financial gap and on Warsaw's chances of covering it.

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materials and spare parts to make use of idle capacity and to get production back on track. In addition, in 1982 Warsaw will need 6-6.5 million tons of grain imports and 600,000 tons of soybean meal to support even reduced livestock numbers. Additional foodstuffs such as meat, butter, and vegetable oils will be required to help satisfy consumer demand. Even assuming good weather in subsequent years, grain and fodder imports will have to increase to enable livestock numbers to recover at a reasonable rate. [ ]

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#### The Muddling Through Scenario

Ad hoc doses of Western aid have so far provided Poland sufficient help to avert default. Western governments have extended \$6 billion in aid this year despite their concern that they might be "throwing good money after bad." For their part, bankers have assiduously avoided default proceedings, despite Poland's technical default status since early this year. The Poles themselves have sharply cut back imports to slow deterioration in their payments position, despite serious harm to production and overall economic performance. [ ]

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Ad hoc aid could continue to be successful for some time because all parties are interested in avoiding default. Western governments are expected to reschedule again next year on the same terms as in 1981 and will probably provide new credits as well. Bankers could grant additional postponements and deferrals of amounts due. The Poles are planning to hold down imports in 1982 despite critical shortages of Western inputs. [ ]

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The major difficulty is that Poland's major sources of European economic assistance all seem unwilling to extend much new credit. (They have less latitude concerning debt rescheduling since the alternative is default.) In economic terms, new money is a poor investment. Credits have to be rescheduled as soon as payments come due and even the long-run prospects for repayment are dubious. While European governments perceive the justification for aid to Poland as political rather than economic, limitations on their ability to influence the course of events in Poland mean that even the political returns are uncertain. [ ]

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In addition, Soviet assistance at current levels is also in doubt. In 1981 Moscow provided \$1 billion in hard currency help, rescheduled much of its hard currency obligations, and--perhaps most important--permitted Warsaw to run a \$2 billion trade deficit. But for next year Moscow has so far insisted on balanced trade; although the USSR may relent somewhat, the Polish deficit seems certain to be reduced. A drop in Soviet assistance will put a further strain on the Polish economy and make it more

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difficult for Poland to meet its financial obligations to the West. [ ]

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Nevertheless, Poland might be able to continue its financial balancing act for some time. Warsaw could stop payments on principal altogether and pay interest obligations on a selective or revolving basis, favoring those creditors most likely to call a default. This approach could work to the extent that creditors prefer to receive some payout rather than writing off debt obligations entirely. [ ]

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### Economic Effects

Even at 1981 levels, ad hoc aid has not helped the Polish economy revive because it has not led to a net flow of resources into Poland to revitalize industry and ease consumer shortages. Warsaw has since early 1981 kept trade in balance and used the excess cash flow resulting from importing on credit and exporting for cash to pay some debt service obligations. This has meant that despite a \$5 billion inflow of credits, Warsaw has reduced hard currency imports by about one-fourth. This cutback in imports from the West has accelerated the decline in industrial output because of Poland's heavy dependence on Western inputs. [ ]

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Warsaw has not only used general purpose financial credits to cover debt service, but also credits tied to purchase of specific commodities. For example, if Warsaw receives a credit for grain that it intended to purchase anyway,<sup>2</sup> the credit frees up the money that would have been spent for grain for other uses--in this case, for paying debt service to creditors rather than for buying more grain or other goods. [ ]

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The Polish government will have to continue this strategy next year unless more debt relief or credits are arranged. The 1982 plan calls for balanced trade, which means that all of the \$4.3 billion in Western credits Poland has requested would be used indirectly to pay debt service that has not been rescheduled. Real imports from the West are scheduled for a further cut, which will sharply reduce short-term chances for economic recovery. [ ]

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Continued placement of priority on meeting debt-service payments to avoid default presents would-be donors with a

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<sup>2</sup> This principle does not apply, however, if credits are tied to goods or amounts that Poland did not otherwise plan to import.

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dilemma. In effect, all of the aid that Warsaw receives is diverted to creditors until it reaches the level of Poland's debt service requirement. The result is a shift in debt exposure toward those creditors most willing to help Poland. The Western Group of Sixteen governments, which hold 47 percent of total Polish debt and 90 percent of official debt (see table 3), thus far have been the most generous. If this continues to be the case, most of Poland's financial gap in the years ahead will consist of payments obligations to creditors who either reschedule on less favorable terms (banks) or do not reschedule at all. [ ]

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### Political Effects

Politically, the Poles have "muddled through" sixteen months of crisis and conceivably could continue to do so, despite further economic deterioration and without significant increase in Western aid. The continuing deterioration of market supplies, despite the wear and tear on the population's nerves, does not make confrontation inevitable. Poles have adjusted, with much grumbling, to deprivation and, [ ] seem to have less fear of the coming winter than they had a year ago. In addition, Solidarity has sufficient credibility and authority to contain local outbursts. [ ]

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Nevertheless, moderates within both Solidarity and the party are coming under increasing pressure from their radical wings. The supply situation has forced the union leadership to adopt a more radical stance than it would have preferred in order to maintain credibility with its members. The endless lines and constant uncertainty have also increased the likelihood that non-economic issues will become points of friction with the regime. The population's willingness to exchange a lowered standard of living for a more pluralistic political system may also be waning. The initial optimism for reform has become tarnished by the realization that the party will agree only reluctantly to any form of "power sharing." [ ]

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The moderate leadership in the party is also being pressured to adopt a more confrontational approach toward Solidarity. The party, which enjoys very little respect or authority, is declining in membership and is becoming more conservative in overall complexion. This will constrict the leadership's ability to work out a modus vivendi with Solidarity. [ ]

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Assuming little or no improvement in economic prospects, the Poles' ability to "muddle through" will depend increasingly on the willingness and ability of Solidarity and the regime to find compromise solutions to difficult problems. In order for the moderates in Solidarity to maintain control of their

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organization, they will have to get sufficient concessions to demonstrate that the government does take Solidarity seriously as a bargaining partner and is willing to negotiate with it in good faith. On some issues such as worker self-management, decentralization of economic control, and possibly access to the media, the two sides seem close enough that some form of agreement is conceivable. It is not clear, however, whether the compromises the government may be willing to offer will meet the union's minimum demands. [ ]

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### Key Pitfalls

One major risk of the muddling through scenario is that the Poles will slip even further behind in covering their financial obligations. Default would follow if even one bank breaks ranks and initiates legal proceedings. The other risk is that further economic deterioration and widening political chaos might yet force a Soviet intervention. The level of Western aid need not play a decisive role in whether Soviet intervention occurs; however, it could contain some economic problems and help to ease consumer distress, thus somewhat lessening the chances. [ ]

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Moratorium or Default--As the Polish financial position becomes increasingly strained, given the immensity of debt service obligations, the banks' insistence that interest be paid, and poor prospects for new credits, the chances increase that Warsaw may be forced to declare a moratorium on all debt payments. The consequences of a moratorium would be difficult to predict with any certainty, given the number of creditors and their different interests and legal requirements. The immediate impact on the Polish economy would be limited by the fact that trade in recent months already has been in balance. [ ]

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An "orderly" moratorium would be hard to organize on short notice. While Western governments would probably accept a moratorium of a year or so, some banks would probably be legally forced to write off a portion of Polish obligations. Non-receipt of interest payments would represent a breach of contractual obligation and, in effect, an extension of new credit to a high risk borrower. [ ]

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Unilateral declaration by Warsaw of a moratorium could provoke any creditor bank to declare default. A declaration of default by a single creditor could trigger cross-default clauses in loan contracts, quickly prompting other creditors to follow suit. Poland's default would be the largest in history and the first by a CEMA country. Default would have much more serious consequences for Poland than moratorium with the outcome depending on a host of complicated legal and financial considerations. Creditors would scramble to seize Polish assets

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in the West, even though their value would offset only a small portion of Warsaw's \$25 billion debt. Cargoes of Polish-titled goods might be seized, reducing export earnings. The conduct of trade would also be hampered by the impact of litigation on the transfer of goods and on payments arrangements. Trade would be balanced at a lower level, and Warsaw might in fact have to generate an export surplus as a cushion. [ ]

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Nevertheless, the negative impact on Poland of a default could be partly offset by certain benefits. Warsaw would be relieved of the huge debt burden and the consequent need to run large trade surpluses in the future. Any additional new government credits or humanitarian aid would, moreover, feed into the Polish economy, rather than be diverted to pay off creditors. [ ]

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The Soviets have given no indication that they would move to prevent Poland's being declared in default. They would certainly try to portray default as a rejection by the West of the Polish experiment and as an embarrassing result of Solidarity activities. Moscow might believe that it could contain the impact of Polish default on its own credit rating and on the ratings of its loyal allies. Not stepping in to prevent Poland's default could also be seen as strengthening the Soviet hand in enforcing conformity elsewhere in Eastern Europe. [ ]

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Default would cause financial damage to the West as well. West German banks, which hold \$1.9 billion in unguaranteed loans to Poland, already have expressed concern about not receiving interest payments; a default which forced them to write off their losses would be a more severe blow. US banks have the second largest unguaranteed debt--\$1.2 billion--but most of this debt is held by large banks able to absorb write-offs. The unguaranteed loans held by other countries include: France, \$900 million; Japan, \$700 million; and Great Britain, \$600 million. [ ]

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Default on guaranteed credits could be costly to several Western governments. West Germany leads with \$2.1 billion in guaranteed credits, followed by the United States at \$1.9 billion, and France at \$1.7 billion. The French figure does not account for the large volume of unguaranteed debts held by newly nationalized banks. Austria could suffer most because its \$1.5 billion in guaranteed debt is large relative to the Austrian budget. [ ]

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The impact of default on the international financial system is difficult to assess, but there seems to be some potential for trouble. If Polish default puts the survival of individual banks

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in jeopardy, Western governments might be called upon to bail them out. Of course, late payments and reschedulings without formal default can put a strain on lenders as well. [redacted]

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The Soviet Intervention Question--While Moscow clearly has been trying to avoid the costs of military intervention, the political and economic situation could deteriorate to the point of requiring martial law and/or a Soviet takeover. The likelihood of this occurring will increase if current government-union talks break down and if strikes and public protests turn into widespread chaos. Insufficient Western (or Soviet) assistance could be a contributing factor, with worsening shortages fueling radicalism on the part of both Solidarity and the regime. The final catalyst to Soviet intervention would probably be the breakdown of social order in the country. [redacted]

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The Poles themselves have sketched out--as one variant of the 1982 economic plan--what they consider an unlikely, pessimistic scenario. Projecting a "continuation of current trends", the Poles forecast under this scenario an additional 8 percent drop in national income and a 10 percent decline in industrial output next year because of domestic strife, reduced external assistance, and a further drop in coal output (to 155 million tons). Private consumption would plummet 11 percent--a politically disastrous decline in the wake of the six percent fall this year. [redacted]

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Such deprivation would test the boiling point of Polish workers, especially if it coincided with a collapse of union-government efforts to reach an accommodation and a belief that the regime was reneging on political concessions. The chances of confrontation would increase substantially. The union leadership would be hardpressed to control unrest and would be tempted toward radical postures to maintain credibility. A desperate regime would come under extreme pressure to use force, a move that could easily fail because the regime's forces would be outnumbered and not entirely reliable. In this setting, a breakdown of law and order could compel Moscow to intervene. [redacted]

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Soviet intervention could, of course, result from any number of factors not directly related to economic conditions. Government intransigence on Solidarity's political demands at the bargaining table could, for example, lead to a general strike, social chaos, and Soviet intervention. Or, given the high level of mutual distrust and the tendency to test the other party's threshold of tolerance, a relatively minor event--such as the early December arrest of the cadet firemen--could lead to a Solidarity-government dispute that gets out of hand. [redacted]

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Intervention would carry very high military, economic, and political costs for Moscow. The extent of the overall costs would vary, depending on circumstances at the time of the invasion and Soviet occupation policies. For instance, if the Soviets invaded only after the Polish situation had evolved into chaos, they might suffer greater casualties but fewer international repercussions. [ ]

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Probable resistance by Polish civilians and some army units could cause substantial Soviet military casualties and losses of lives and equipment, particularly if there were a prolonged period of guerrilla resistance. Numerous Soviet divisions would have to remain for some time in Poland as a police force, and Poland would cease indefinitely to play its traditional Warsaw Pact role. As a result, the USSR would have to make major revisions in strategic and operational planning. [ ]

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In addition to the direct economic costs of intervention, the Soviets would be forced to deal with Poland's massive internal economic and foreign debt problems in order to buttress a new hardline regime, reestablish political stability, and maintain Poland's role within CEMA. Moscow at the least would have to double the roughly \$4 billion provided this year in credits and in direct and indirect subsidies to Poland; its costs would be considerably greater if Polish factories and mines suffered extensive damage through sabotage. The Soviets must also take into account the impact of a possible US grain embargo and other Western economic sanctions. Along with the curtailment of its own economic ties with the West, Moscow might incur the indirect costs of disruption of Western trade with the other East European countries as well. [ ]

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Moscow's efforts to woo the West Europeans by touting the political advantages of detente would suffer a sharp setback, leading to at least a temporary resurgence of support for NATO and curtailment of ties with the USSR. Over the longer term, however, the West Europeans might argue that Soviet occupation of Poland had reduced the Soviet military threat to them. Outside Europe, the Soviets would suffer a political setback throughout the Third World, a development that would probably cause them the greatest concern in the Middle East. Military occupation of Poland might reduce Soviet willingness to intervene extensively in Third World conflicts. Prospects for the disarmament talks with the US would suffer a major setback; military cooperation between the US and China, and perhaps Japan, would receive further impetus. [ ]

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A Soviet decision not to intervene, on the other hand, might carry costs that are even longer lasting. Notably, a liberalized Poland could give rise to new pressures for change elsewhere in

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Eastern Europe. Although the East European regimes would probably be able to contain these pressures for a while, it is questionable whether they could do so indefinitely. In particular, the example of a Poland creating its own model of socialism and dealing successfully with its problems would give impetus to those elsewhere who advocate differing national roads to socialism. [ ]

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Within the USSR, the growing belief that aid to the Poles makes life more difficult for the Soviet consumer may further aggravate popular frustration over food shortages. The Soviet regime already appears to be drawing public criticism for its indulgence toward Poland and has faced scattered strikes and demonstrations in the Western republics. Issues relating to Poland could also have an increasingly divisive effect within the Soviet leadership and might figure prominently in the succession. Finally, a liberalized Poland, while not completely unreliable, would be of questionable military value to Moscow and would probably require changes in Warsaw Pact planning. [ ]

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#### Large Scale-Coordinated Aid

An alternative to the ad hoc approach to aid for Poland would involve Western governments and the 460 Western bank creditors working together to provide a large-scale coordinated assistance program. For this approach to be successful, Poland's other major creditors--notably the USSR, Brazil, and some Arab governments--would somehow have to be brought into at least tacit cooperation. Such a massive effort would provide Warsaw with near-total relief from debt service and enough new funds to finance a trade deficit for several years. The likely impact of such massive aid would of course depend on critical factors such as the ability of the regime to use aid effectively and to reach a political accommodation with Solidarity. No aid program can guarantee that economic goals will be met and political upheaval avoided. [ ]

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The West probably could impose some conditions on a massive aid program, particularly if it included new loans. Among the approaches to conditionality, the West would consider:

- A large and long-term aid commitment, proffered with no more strings than pro-forma economic conditions, similar to those established for official debt rescheduling. This would greatly ease Warsaw's current financial and resource strains and the uncertainty over future availability of hard currency. An essentially open-ended aid commitment, however, is probably unrealistic in terms of European political realities and would remove

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the pressure on the Polish government to sustain the momentum of liberalization. It would ease Moscow's political dilemma as well as its need to provide economic support. [ ]

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- A politically-oriented aid approach--e.g., an offer to provide substantial aid if the Polish government committed itself to an economic recovery program bearing the endorsement of "key elements of Polish society" (Party and Solidarity). Aid would be disbursed in tranches, based on performance. To enhance the acceptability of such conditions to both Warsaw and Moscow, the IMF could be used as a vehicle for formulating and monitoring the economic program. [ ]

Publicly, Moscow would criticize an aid offer tied to political conditions as an attempt to acquire influence over internal Polish affairs. Privately, the Soviets might tolerate Polish acceptance but press the Poles to water down the conditions, to insist where possible that conditions be in the form of private "understandings," and to minimize compliance. Moscow would probably refuse to countenance overtly political conditions that would weaken the party, for example, an explicit sharing of policymaking power with Solidarity. It might also try to veto any radical introduction of market mechanisms or worker self-management, and it would vigorously oppose Western oversight of Polish economic policymaking. Moscow might tell the Poles that, if they accepted economic policy conditions, they should then undertake tougher measures against political liberalization.

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In order to maximize chances that massive aid would have the intended positive impact, the approach taken would have to ensure that all substantial creditors cooperate in coordinating assistance. The latter condition is important in ensuring that aid by one donor would not be siphoned off to pay debt service to other creditors and especially that there would be no leakage of Western help to the USSR. [ ]

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In order to relieve Warsaw almost completely from debt service, for a time, Poland's economic partners would either have to agree to a near-total debt moratorium or to a rescheduling of close to 100 percent of debt service. After a couple of years, Warsaw could begin paying a gradually increasing portion of its debt service obligations. In addition, new credits would be required to allow imports to increase back to 1980 levels by late 1982 and to revive positive real economic growth. The following contributions would be needed:

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- Western governments would 1) reschedule all principal and interest payments on official and guaranteed credits, including the interest on amounts rescheduled in 1981, or agree to a moratorium; 2) extend credit guarantees (with long grace and repayment periods) to support exports to Poland of some \$1 to \$2 billion in food, grain, raw materials, semi-finished products, and spare parts; 3) establish a burden sharing formula; and 4) encourage their banks (perhaps with financial support) to go along with 100 percent rescheduling or a moratorium on non-guaranteed loans. [ ] 25X1
- The most difficult sacrifice on the part of Western banks would be agreement to reschedule interest payments or to accept a moratorium, either of which might create legal as well as financial problems for them. Banks need interest payments not only for income but to satisfy government auditors and regulators. [ ] 25X1
- The IMF could provide substantial direct aid, perhaps roughly \$1 billion a year, after membership negotiations are completed in the fall of 1982. This could bolster the confidence of Western creditors about Poland's financial future. The IMF could also contribute its expertise to help design and administer an economic stabilization program. The IMF might serve a useful role as a multilateral, technically oriented institution which could make Western aid politically more palatable to the regime, the Soviet Union, and Solidarity. [ ] 25X1
- The USSR would have to cooperate in a general assistance program to ensure equitable burdensharing and to prevent Western resources from, in effect, flowing out of Poland to the USSR. At a minimum, the Soviets would have to forgo all debt service on the \$1.2 billion in hard currency owed them and on the \$700 million owed to two CEMA banks. It is also important that Moscow continue the large net flow of resources to Poland through the bilateral trade account. Moscow eventually may prove more flexible about a continued Polish trade deficit, and it might make further concessions regarding the debt service on Poland's hard-currency loans. The West would need to press Warsaw to persist in demanding continued help from the USSR. The Soviets are unlikely, however, to commit themselves in advance, given their suspicion of Western intentions and their interest in maintaining economic leverage over the Poles. [ ] 25X1

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In the short run, large scale Western aid could serve to alleviate the Poles' economic distress by helping to overcome shortages of food and critical goods for the industrial sector. It could also give the regime breathing space in which to implement needed but unpopular measures to deal with the immediate--as well as some of the deep-seated--obstacles to Polish economic recovery. It might create a psychological climate in which the government could persuade Solidarity and the populace to accept needed austerity and economic rationalization. [ ]

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The longer run economic impact depends not only on the amount and conditions of aid, but on Warsaw's success in building trust with the people, solidifying an accommodation with Solidarity, and implementing the kind of programs needed to cure Poland's economic ills. In other words, aid is a necessary but not a sufficient condition for economic recovery. [ ]

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If the preconditions were met, aid could help Warsaw to take advantage of the basic strengths of the Polish economy--i.e., skilled labor force, intact capital stock, and abundant natural resources. There is ample room for expansion from the present low levels of resource utilization. Over the longer run, the key to successful use of aid is the implementation of effective economic policies, including:

- More rational allocation of a limited amount of investment to and within critical sectors such as agriculture, energy, and transportation.
- Incentives for private agriculture.
- Elimination of supply-demand imbalances in the market for consumer goods; and
- A more rational trade policy aimed at limiting total imports and giving priority to essentials while providing a stimulus to exports. [ ]

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These policies seem to require prices--including wages and exchange rates--that reflect supply and demand pressures. They also would require a suitable response to these price signals by economic decisionmakers, including government planners and managers as well as workers and consumers. [ ]

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There is wide popular support for significant changes in the economic system in the direction of greater decentralization and self-management, but such changes in the control structure could have a distinctly negative economic impact if the system is not also made responsive to supply and demand pressures.

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Stabilization reforms that brought higher prices for consumer goods, closure of uneconomic enterprises, and other forms of austerity would be very unpopular. The regime and Solidarity would have to work together to limit the inevitable disruptive effects.

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Over the longer term, an accommodation between Solidarity and the government that permitted both decentralization and stabilization could facilitate economic recovery, increase the chances that Western creditors eventually would get their money back, and improve the climate for a successful new Polish "model" of communism. Nonetheless, great uncertainty would remain for at least several years. The regime, Solidarity, and the Catholic Church would be engaged in continual political maneuvering; both the government and the union would suffer from internal differences; tenuous agreements might come undone; and consumer expectations would continue to be frustrated to some extent.

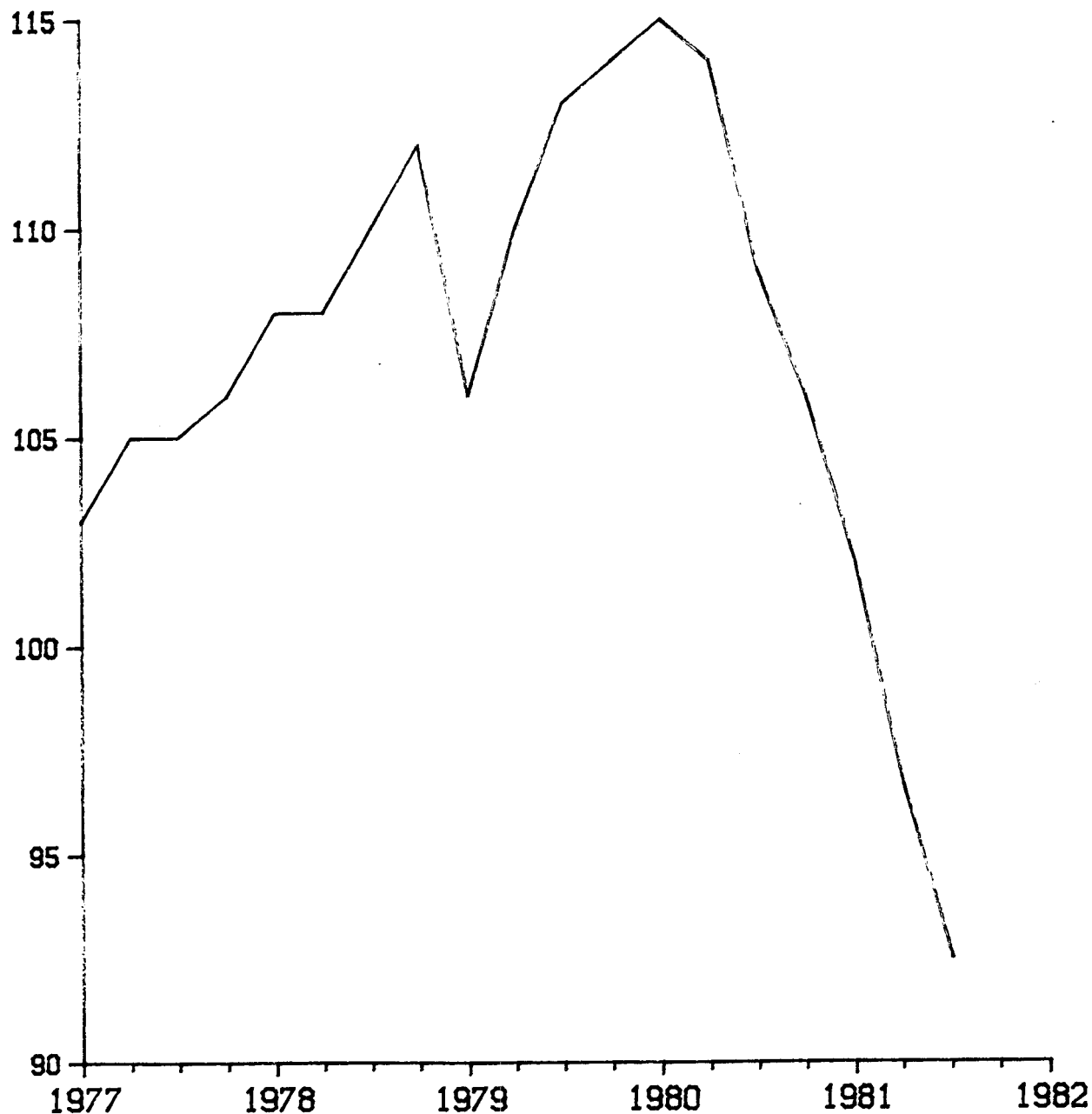
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In this emerging Poland, the Party would legally retain its leading role in Polish political life, but Solidarity would increasingly become a participant in decision-making. Other social interest groups would assume a more autonomous existence outside strict party control, and parliament might become more of a forum for real discussion of policy options. Direct party control of the economic system would be diluted as the economy became more decentralized. Poland would remain an integral member of the Warsaw Pact and CECA, although its evolving domestic system would cause tensions with its allies.

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# Poland: Industrial Production<sup>a</sup>

Index: 1976 4th Qtr=100



a. Seasonally adjusted at an annual rate.

Table 1  
Poland: Selected Economic Indicators <sup>1</sup>

	<u>1980</u>	<u>1981</u> <u>Plan</u>	<u>1981</u> <u>Projected</u>	<u>1982</u> <u>Plan</u>
National Income <sup>2</sup>	96.0	92.8	82.1	80.9
Industrial Production <sup>2</sup>	98.7	98.7	85.9	85.9
Coal (mln. tons)	193.1	188	164	168
Copper (th. tons)	357.3	340.0	330.0	340.0
Silver (tons)	766	675	683.0	685.0
Agricultural Production <sup>2</sup>	90.4	93.8	93.9	98.5
Grain (mln. tons)	18.3	19.5	20.5	21.0
Potatoes (mln. tons)	26.0	40.0	43.0	43.5
Net Investment <sup>2</sup>	94.9	75.4	73.4	68.6
Money Income <sup>2</sup>	112.8	133.1	141.0	154.0
Market Supplies <sup>2</sup>	100.6	103.1	108.3	104.7
Imports From The West (bln. dollars)	8.2	7.2	6.3	6.7
Exports To The West (bln. dollars)	8.5	6.5	5.8	6.7

<sup>1</sup> Official Polish data

<sup>2</sup> 1979 = 100

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Table 2

## Poland's Hard Currency Imports, 1981-1985

<sup>1</sup>(Billion US \$)

	1981	1982	1983	1984	1985
	<u>projected</u>	<u>plan</u>	<u>plan</u>	<u>plan</u>	<u>plan</u>
Total	6.3	6.7	7.2	7.8	8.4
(Food and Agricultural Products)	2.75	1.4	1.1	1.0	0.9
(Semifinished Products)	1.35	2.0	2.5	2.6	3.0
(Raw Material)	.38	0.8	1.2	1.3	1.4
(Manufactures)	1.63	1.7	1.8	1.9	2.1

<sup>1</sup> Official Sources. Assumes 8 percent annual inflation rate.

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Table 3  
Poland: Hard Currency Debt, end-August 1981<sup>1</sup>

<u>Creditors</u>	<u>Total</u>	<u>Official</u>	<u>Unofficial</u>
Total	23,422	12,325	11,097
Group of 16 <sup>2</sup>	18,587	11,107	7,480
US	3,053	1,895	1,158
FRG	4,056	2,137	1,919
France	2,582	1,701	882
Austria	1,817	1,509	308
United Kingdom	1,781	1,150	631
Italy	1,088	750	338
Japan	1,063	357	706
Other	3,147	1,608	1,538
Socialist	2,270	74	2,196
USSR	1,168	—	—
Eastern Europe	132	—	—
CEMA Banks <sup>3</sup>	712	—	—
Polish Banks in the West	258	4	253
Arab Countries	451	254	197
Other	2,114	890	1,224
Brazil	1,534	784	750

<sup>1</sup> Source: Official Polish data. Includes medium- and long-term debt only; short-term debt is \$1.2 billion. Totals may not add because of rounding.

<sup>2</sup> Sixteen Western countries which reschedule official Polish debt under a multilateral agreement.

<sup>3</sup> The International Bank for Economic Cooperation and the International Investment Bank.

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Table 4: Poland: Financing Needs

Billion US dollars

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1987</u>	<u>1989</u>	<u>1990</u>
Financing requirement	8.6	8.4	7.3	7.6	6.8	7.4	9.0	10.3	8.7	7.3
Current Account Balance	-2.2	-1.6	-1.4	-1.9	-1.3	-0.6	+0.1	+1.0	+2.1	+3.5
Net Exports	-0.5	---	0.5	1.1	1.8	2.6	3.4	4.2	5.2	6.3
Interest	2.6	3.3	3.1	3.8	4.0	4.2	4.3	4.3	4.2	3.9
Other	0.9	1.7	1.2	0.9	.9	1.0	0.8	1.1	1.1	1.0
Principal Repayments	6.4	6.8	5.9	5.7	5.5	6.8	9.1	11.3	10.8	10.8
Hard Currency Debt	26.0	28.0	29.8	32.2	34.0	35.1	35.5	35.0	33.6	30.6

Source: Official Polish plans

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